

**TESTIMONY OF THE MONTANA SOCIETY OF CPAS
IN SUPPORT OF SENATE BILL 557
CLARIFICATION OF THE CAPITAL GAIN CREDIT**

CURRENT LAW

Under current Montana individual income tax law, an individual is allowed a 1% credit against their net capital gain income that is taxed. In calendar years 2007 and forward, the credit is 2% of the net capital gains income.

All resident, part-year resident and non-resident taxpayers are eligible for the capital gain credit as long as they have net capital gain income. A Montana resident receives a credit for all net capital gains that are Montana sourced and non-Montana sourced that he/she reports to Montana.

ISSUES

- A non-resident who has non-Montana net capital gain income receives the credit even though his Montana sourced income does not contain any Montana sourced capital gain income.
- Credits are allowed by the Legislature to improve one or more aspects of Montana's economy or address a specific issue. The credits are directly tied to activities in Montana. Under current law, a non-resident who has capital gain income that is not sourced in Montana will receive a capital gain credit against his Montana tax liability.
- The state is losing tax revenue by allowing the capital gain credit to non-residents who have out-of-state capital gains.

PROPOSED LAW

The proposed bill prorates the capital gain income by the ratio of "Montana source capital gain income to total capital gain income".

ADVANTAGES

- This amendment to the bill eliminates non-residents receiving a capital gain credit for capital gain income that is not Montana sourced.
- This will continue to allow residents who have out-of-state capital gain income to receive a capital gain credit since residents are taxed on all of their income no matter where it is earned.

POSSIBLE QUESTIONS/COMMENTS

Isn't the Non-resident capital gain credit already prorated?

- Currently, a non-resident is taxed on all of their income and then their Montana tax is figured on a ratio of Montana source income to their total income. The non-resident receives the capital gain credit before the tax is prorated. So yes, the non-resident's Montana tax liability is prorated and so is the capital gain credit. However, a non-resident can and does receive a capital gain credit on non-Montana source income.

If a capital gain credit is already prorated, why do we need this bill?

- Good question. Under the current form, the non-resident reduces the tax liability on all of his income by the capital gain credit. Then the net tax is prorated to arrive at the non-resident's Montana tax liability. If a non-resident has non-Montana sourced capital gain income, they still receive a prorated portion of the capital gain credit even though the capital gain income is not Montana sourced.

EXAMPLE

<u>INCOME</u>	<u>MONTANA</u>	<u>OUT-OF-STATE</u>	<u>TOTAL</u>
Wages		\$50,000	\$ 50,000
Rental Income	\$20,000		\$ 20,000
Capital Gain	_____	<u>\$50,000</u>	<u>\$ 50,000</u>
TOTAL	\$20,000	\$100,000	\$120,000

CURRENT LAW

Capital Gain credit is equal to $2\% \times \$50,000 = \$1,000$

Tax on \$120,000 = \$8,280 - \$1,000 = \$7,280

Non-resident's Proration % = $\$20,000 / \$120,000 = 17\% (.17)$

Non-resident's tax = $\$7,280 \times .17 = \mathbf{\$1,237.60}$

Note: The non-resident is receiving a \$170 capital gain credit even though he did not have any Montana sourced capital gain income.*

PROPOSED LAW

Capital Gain credit is equal to $2\% \times \$50,000 = \$1,000$

Non-resident's prorated Capital Gain Credit = $0 / \$50,000 = 0$

Tax on \$120,000 = \$8,280

Non-resident's Proration % = $\$20,000 / \$120,000 = 17\% (.17)$

Non-resident's tax = $\$8,280 \times .17 = \mathbf{\$1,407.60}$

DIFFERENCE

Proposed law - Current law = $\$1,407.60 - \$1,237.60 = \mathbf{\$170.00}$

Or 17% of the Capital Gain Credit \$1,000 = $\mathbf{\$170.00^*}$